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TAGS: EFIN ECON ETRD EIND EINV EUN
SUBJECT: EUROPE FINANCIAL AND ECONOMIC REPORT: May 19th, 2009
FINANCIAL SERVICES: UPCOMING ISSUES /EVENTS

Commission to publish its blueprint for implementing the de Larosiere proposals:
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¶1. (SBU) On May 27, the European Commission will publish a Communication setting out its vision for a new European supervisory framework, based on two new pillars:
--The European Systemic Risk Council (ESRC), which will monitor and assess the risks to financial stability, provide early warning of systemic risks and recommend actions to address these risks; and,
--The European System of Financial Supervisors (ESFS), a network of national supervisors working with the new European supervisory authorities (enhanced Level 3 Committees). The aim is to enhance cooperation between national supervisors, ensure that host supervisors have an appropriate say in the supervision of their own financial systems, and that cross-border risks are addressed more effectively. With this Communication the Commission takes the next step in the implementation of the de Larosiere proposal, and it is expected to be discussed by the June 9 ECOFIN. The Commission seeks an endorsement of its views by the Spring European Council (June 18-19), to open the way for the legislative proposals expected for this fall.

FINANCIAL SERVICES: RECENT EVENTS:

European Parliament approves the revised Capital Requirement Directives (CRD):

¶2. (SBU) On May 6, the European Parliament (EP) adopted by a 454-106 vote the revised Capital Requirement Directives that: set new rules limiting banks' exposure to a client or a group of clients, establish colleges of supervisors to oversee banking groups operating in multiple EU countries, and set EU-wide criteria for assessing when "hybrid" capital may be recognized as "original own funds." The Directives also require originators of securitized products to retain some risk exposure to these securities (no less than 5% of the total originated); and purchasers of securitized products to conduct comprehensive diligence. The Council must now approve the proposals. Member States will have until 31 January 2010 to put the necessary laws into place, and the provisions will be applicable from 31 March 2010.

McCreevy calls for improvement in IASB governance:
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¶3. (SBU) On May 7, Commissioner McCreevy called for a greater link between the International Accounting Standards Board (IASB) members and the countries actually using IFRS, and welcomed the recent decision of the European Parliament and of the Council to provide funding to the International Accounting Standards Committee Foundation (IASCF). The funding will be conditioned on further improvements in IASCF governance. McCreevy noted the growing concern among Finance Ministers at the perceived slowness of the

IASB in responding to the crisis, and characterized the IASB's approach to standard-setting as being 'over-academic'.
Link: McCreevy's speech

EU to stress-test banks. No results will be disclosed:
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¶4. (SBU) On May 12, the Committee of European Banking Supervisors (CEBS) announced that a stress test exercise is currently being undertaken by national authorities on EU banks using common scenarios and guidelines developed by CEBS. The aim is to assess at an aggregate level the EU banking system's resilience to shocks, not to identify individual banks' need for recapitalization. The exercise will end in September and the results will be kept confidential.
Link: CEBS's statement on the stress test

DG ECFIN Director General calls for greater disclosure of EU banks' true health:
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¶5. (SBU) On May 13, the European Commission Director General for Economic and Monetary Affairs, Marco Buti, highlighting the need for European banks to disclose their state of health, particularly after the recent publication of the results of the stress test performed on the 19 top U.S. banks. Buti's comment echoes the conclusions of the last IMF Regional economic outlook report for Europe, released on May 12, which calls for better co-ordination of the EU economic stimulus and bank rescue schemes, and advocates the use of stress tests on individual banks (along the example set by the U.S). Link: IMF Regional economic outlook report for Europe

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Germany resists disclosing stress test results, plays down significance of US stress tests:
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¶6. (SBU) According to the FT Deutschland, EU Finance Ministers agreed last month to carry out stress tests on a voluntary basis, and bowed to German pressures that the results of the tests not be disclosed. Moreover, German Finance Minister Peer Steinbruck told the Bundestag, on May 13, that the US stress tests were pointless because the US Treasury and the Federal Reserve had manipulated the figures beforehand, the FT reports.

German government adopts "bad bank", criticized by experts:
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¶7. (SBU) On May 14, the German government approved a "bad bank" program. Banks can voluntarily set up an off-balance sheet vehicle and transfer assets to it. The off-balance sheet vehicle then pays for the assets at 90% of their book value with government guaranteed securities. Each year the banks will pay the government the difference between the assets' discounted book value and "fundamental" values as determined by auditors. Under the proposal, banks are responsible for all losses on the transferred assets, but they can stretch them into the future. Experts have noted that this scheme could make it difficult for banks to raise new capital, as there would be considerable uncertainties over future losses, and the banks will not be able to pay dividends for long periods. The government rejected proposals from parliamentarians to make the scheme obligatory. The German Banking Association has criticized the scheme as too onerous. A vote in the German parliament is scheduled for before the July 3 summer recess.
Belgian government provides state guarantees to KBC:
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¶8. (SBU) On May 13, KBC Group, Belgium's third-largest bank by assets, accepted state guarantees to cover 90% of losses exceeding 3.2bn largely due to write-downs on assets insured by MBIA Inc. The bank will pay the Belgian government 1.2bn plus a quarterly fee of 30 million for the guarantee, which covers 5.5bn of collateralized debt obligations and 14.4bn of MBIA insurance

coverage. The bank will also sell 1.5bn of non-voting securities to the Flemish regional government. KBC is receiving government funds for the third time since October following credit-related losses.

ECONOMICS / FINANCE: UPCOMING ISSUES / EVENTS

May ECOFIN discuss current economic and financial situation, sustainability and quality of public finances, and tax-related issues:
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¶9. (SBU) The May 5 ECOFIN Council discussed the Commission's newly revised economic forecast, which predicts a 4% contraction this year. Ministers emphasized Member States should strengthen public finances through rapid reduction of debt, support for employment and productivity, and reform of pension, health care and long-term care systems. Concerns about growing divergences in U.S. and EU accounting standards were discussed; the June ECOFIN will return to this after additional staff work. Commissioner Almunia indicated that Poland, Romania, Lithuania, Latvia and Malta will be the next five countries to receive warnings from the European Commission under the excessive deficit procedure. Ministers also formally adopted the Solvency II Directive and the Credit Rating Agencies Regulation, and agreed to raise the balance of payments facility ceiling from 25bn to 50bn. Outgoing Czech Finance Minister Kalousek used the press conference to note that the G-20 should not have published the list of uncooperative tax jurisdictions, and apologized to Belgium, Luxembourg and Austria as he believes they should not have been on the list.
Link: Council conclusions
Link: Conclusions on the sustainability of public finances
Link: Ageing report 2009

ECB trims rates and adopts slight QE; BoE expands asset purchase program:
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¶10. (SBU) On May 7, the ECB Governing Council agreed to a 60bn program to buy euro-denominated covered bank bonds issued in the Euro area. While small, this is a first step towards quantitative

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easing. The ECB also reduced its main refinancing interest rate by 25 basis points, to a historically low 1%. The interest rate of the marginal lending facility was also cut by 50 bps, to 1.75%. The rate on the deposit facilty was left unchanged at 0.25%. The ECB also ecided to double the maximum length of its refinancing operations to 12 months. On the same day, the Bank of England decided to leave the interest rate unchanged at 0.5%, but increased the size of the asset purchase program by GBP 50bn.

March industrial production down by 2.0% in euro area, by 1.9% in EU27:
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¶11. (SBU) In March 2009, industrial production fell by 2.0% in the euro area, and by 1.9% in the EU27 compared with February 2009, when output was down by 2.5% and 2.2% respectively. Compared with March 2008, industrial production declined by 20.2% in the euro area and by 18.8% in the EU27.

Germany expects 2009 tax revenue to decline more than previously estimated:
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¶12. (SBU) Germany's 2009 tax revenue is now estimated to decline by over 300bn, compared to previous estimates, as a direct result of the global economic crisis (which, according to FT Deutschland, would account for two thirds of the decline).

European GDP figures for Q1 show continued decline:
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¶13. (SBU) In Q1 2009, GDP declined by 2.5% q-o-q in both the euro area and the EU27. GDP decreased by 4.6% y-o-y in the euro area, and by 4.4% y-o-y in the EU27. National figures for Q1 show that:
--Germany's GDP contracted by 3.8% (q-o-q) and by 6.9% on an annualized basis;
--French GDP declined by 1.5% (q-o-q), leading the French statistical office to revise its growth forecast for 2009 down to -3%;
--UK's GDP registered a -1.9% q-o-q (4.1% annualized);
--Italy has recorded a negative growth of 2.4% q-o-q (-5.9% annualized), and revised 2009 growth forecasts to -4.6%, 0.2% less than previously anticipated;
--Spain's GDP fell by 1.8% (q-o-q).

MURRAY